IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

No. 189

FRANK A. BARLOW, TRUSTEE OF THE ESTATE OF THE LIBERTY POSTER COMPANY, A CORPORATION, BANKRUPT, *Petitioner*,

vs.

W. P. BUDGE, CLAIMANT,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WILLIAM M. GILLER,
Attorney for Petitioner,
400 Brandeis Theatre Building,
Omaha, Nebraska.

M. E. CULHANE AND
L. H. JOSS,
Of Counsel,
Minneapolis, Minnesota.

Hayward Brief Co., 861-7 Fourth Ave. So., Minneapolis

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, FRANK A. BARLOW, trustee of the estate of the LIBERTY POSTER COMPANY, a corporation, bankrupt, in support of the petition for Writ of Certiorari, to be directed to the United States Circuit Court of Appeals for the Eighth Circuit, to review a judgment rendered on the 20th day of April, 1942, which affirmed the judgment of the United States District Court for the District of Minnesota, Fourth Division, dated December 31, 1940, which affirmed the order of the Referee in Bankruptcy, allowing the claim of W. P. Budge in the sum of $4,950.00, and the District Court order, dated February 18, 1941, denying a motion for a rehearing and reconsideration of the judgment, dated December 31, 1940, respectfully shows:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED

Petitioner is the trustee of the estate of the Liberty Poster Company, who had been engaged in the printing business at Minneapolis. For several years before supervening bankruptcy, the corporation had only three stockholders, each holding one-third of the capital stock and had held no stockholders' or directors' meetings. The corporation had only two directors and officers, to-wit: W. P. Budge, hereinafter called respondent, who kept the books and signed the checks, and Charles A. Rose, who managed the plant. These two officers had the sole domination and control of the business. They operated the business in the same free manner as a copartnership or joint venture.

Respondent filed a claim against the bankrupt estate for $4,950.00 for money that he had contributed to the corporation to save it from financial difficulty and to preserve his investment. As a result of such contribution, the corporation's financial standing and reputation in the community was preserved and the corporation continued to receive credit. The Supreme Court of Minnesota holds that creditors deal with a corporation on the faith of its financial standing and reputation in the community, which in turn is based on the professed and supposed capital, although such creditors have no personal knowledge of the amount of the professed capital. If respondent had not made such contribution, the corporation would have been forced to liquidate, the general creditors, hereinafter described, would not have extended credit, would have suffered no loss and would not now be creditors of the corporation. By "General Creditors," we refer to those creditors who extended credit to the corporation after July 1, 1937, after respondent had ceased

to contribute and the only creditors whose claims had been filed and allowed. The total of the claims of these creditors is $9,182.33.

Petitioner as trustee objected to the allowance of the claim of respondent upon the following ground: The business was operated as though it were a partnership or joint venture. Respondent's claim constituted a contribution to capital. Respondent and Rose committed a fraud on the general creditors because they incurred said debts when they knew such debts could not be paid in full, especially if respondent were to compete with them for the payment of his contribution, because of the then financial condition of the corporation.

The Referee in Bankruptcy and the District Court found no disputed question of fact. There could be no disputed question of fact since the evidence was limited to the testimony of respondent and the corporate records kept by him. There are not sufficient assets to pay the claims of general creditors.

The necessity for contributions by respondent arose from unauthorized withdrawals by himself and Rose, which eventually impaired the corporate capital. The contributions were made from time to time during 1935 and 1936 without any agreement for repayment or the taking of a note or notes. For the years 1927 to 1931, inclusive, the corporation had operated at very little profit. For the years 1932 to 1934, inclusive, the corporation suffered very substantial losses. If the contribution is sustained as a debt, rather than a capital contribution, it increased the debt beyond the limit fixed by the charter. After the making of the contribution, the corporate debts continued to increase until at the time the debts to general creditors were incurred the total debt exceeded the debt limit fixed by the charter

by an amount greater than the contribution of the respondent.

The debts of the general creditors were contracted by respondent and Rose after the financial condition of the corporation had become so bad that respondent was unwilling to and did not make any further contribution. The contribution made by respondent in no way benefited the general creditors. In fact, if the contribution had not been made, the corporation would have been obliged to liquidate before it obtained credit from the general creditors. In obtaining credit from the general creditors the respondent well knew that the claims of such creditors would not be paid in full, especially if he were to compete with them for the payment of his contribution.

The referee treated the issue as one between respondent and the corporation, and since the corporation had received the money, respondent's claim was allowed. The referee failed to consider that there was any issue between the respondent and the general creditors, although the same was urged upon him. Upon review, the District Court affirmed the allowance of respondent's claim, treating the issue as being one between respondent and the corporation, although it was urged by the trustee that the issue was one between the respondent and the general creditors. The trustee made a motion for a rehearing and reconsideration of the Court's order affirming the order of the referee, urging upon the District Court that there was no disputed question of fact, that the issue was not one between respondent and the corporation but between respondent and the general creditors. That motion was overruled. An appeal was taken to the Circuit Court of Appeals, and again the trustee urged upon that Court that the issue was one between respondent and the general creditors. The Circuit Court of Appeals by a divided court, affirmed the District Court. Circuit Judge

Johnsen in a dissenting opinion said he would reverse the judgment of the District Court. The Court in the majority opinion conceded that the bankruptcy court might have subordinated the claim of the respondent to that of the general creditors, but in explanation of its failure to do so, said:

> "We hesitate to say, however, that, under the evidence, the court of bankruptcy was compelled to subordinate Budge's claim to the claims of other creditors, believing, as it did, that Budge was guilty of no fraud and of no unfairness in his dealing with the bankrupt."

In other words, the issue considered was one between respondent and the corporation and not between respondent and the general creditors. The closing paragraph of the majority opinion indicates that the bankruptcy court, although there was no disputed question of fact and although the applicable equitable principles have been well settled by this Court, might exercise its discretion as to subordinating the claim of respondent. The Court's language is as follows:

> "We think that the duty and responsibility of determining whether, under the applicable law, the claim of Budge was upon an equitable parity with the claims of other creditors was primarily that of the bankruptcy court, which was charged with the administration of this insolvent estate, and that this court would not be justified in setting aside the order appealed from unless convinced that it was clearly erroneous. We are not convinced that it was clearly erroneous."

B.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

1. The judgment of the Circuit Court of Appeals in the case at bar is in conflict with the decisions of this Court in *Taylor vs. Standard Gas & Electric Co.*, 306 U. S. 307, 59 S. Ct. 543, 83 L. Ed. 669; *Pepper vs. Litton*, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281, and *Sampsell vs. Imperial Paper & Color Corp.*, 313 U. S. 215, 61 S. Ct. 904, 85 L. Ed. 1293, and the law and the equitable principles clearly set forth in these opinions.

2. That this petitioner has not had his day in court on a decisive issue shown to exist by the undisputed evidence, that is, the issue between the respondent and the general creditors as to whether respondent's claim should be subordinated to the claims of the general creditors. Such issue was not considered either by the referee, District Court or the Circuit Court of Appeals, although at all times urged. In the petition for rehearing the attention of the Circuit Court of Appeals was called to this issue, that is, that the Court had inadvertently overlooked it.

3. The Circuit Court of Appeals has decided an important question of bankruptcy law and administration that has not been but should be settled by this Court. That is, where the undisputed facts are sufficient under well established principles of equity as enforced in bankruptcy to require a claim of a dominant stockholder, director and officer to be subordinated to the claims of creditors, it is discretionary with the bankruptcy court as to whether such claim shall be subordinated. We respectfully submit that the holding of the Circuit Court of Appeals in the case at bar which is to the effect that it was discretionary with the bankruptcy court as to whether the claim of the respondent should be sub-

ordinated to that of the general creditors is *erroneous.*

Wherefore, your petitioner respectfully prays: That a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and all of the proceedings in this cause, to the end that said cause may be reviewed and determined by this Court, as provided by law, and that your petitioner may have such other and further relief as to this Court may seem proper and be in conformity with the law.

And your petitioner will ever pray.

WILLIAM M. GILLER,
Attorney for Petitioner,
400 Brandeis Theatre Building,
Omaha, Nebraska.

M. E. CULHANE AND
L. H. JOSS,
Of Counsel,
Minneapolis, Minnesota.